Office of Chief Counsel
Internal Revenue Service
memorandum

CC:W:DEN:TL-N-6136-97
MSHeroux

date: 11 AUG 1999

to: Joyce Schulte, Case Manager

from: District Counsel, Denver CC:W:DEN

subject: [redacted], f/d/a [redacted]
Summons Enforcement

ISSUES

This memorandum refers to your June 18, 1999, request for our opinion with respect to:

(1) Does the COLI issue in the [redacted] case meet the definition and requirements governing designation of tax shelters?

(2) If the COLI issue is classified as a tax shelter, are there fewer types of documents that can be withheld under the attorney-client privilege and the work-product doctrine?

(3) Enforcement of summonses dated [redacted], [redacted], and [redacted], requesting all documents and correspondence relating to the evaluation of the COLI products at issue for compliance with I.R.C. § 7702.

CONCLUSIONS

(1) and (2). The COLI issue in the [redacted] case probably meets the definitions of tax shelters set forth in I.R.C. § 461(i)(3), 6111, and 6662(d)(2)(C)(iii). It is also unlikely that penalty relief under § 6662(d)(2)(B) is available to the taxpayer. But your request focuses on the affect that designating the COLI issue as a tax shelter would have on the attorney-client privilege and the work-product doctrine. As we stated in our August 6, 1999, memorandum to you, there is no tax shelter exception to the attorney-client privilege or the work-product doctrine. Therefore, designating the COLI issue as a tax shelter would have no affect on claims of document protection under the attorney-client privilege or the work-product doctrine.

(3) It is our understanding that [redacted] the summonsed party in the [redacted] and [redacted] summonses, has not claimed privilege with respect to the documents requested in those summonses. We do not know the

[redacted] f/k/a [redacted]
[redacted] Summons Enforcement

extent of [redacted]'s compliance with those summonses, therefore we do not know what items listed in the summons warrant enforcement. If you wish to pursue enforcement of the [redacted] and [redacted] summonses, please provide us with details of the requests to be enforced pursuant to the summonses.

Two summonses were issued to [redacted] on [redacted]. Copies of these summonses are attached hereto as Exhibit A. Copies of [redacted]'s responses (without attached exhibits) dated [redacted], [redacted], [redacted] and [redacted] are attached as Exhibits B, C, D, and E, respectively. The relevant privilege log is the third amended privilege log attached to Exhibit D. That log claims privilege to communications responsive to document requests 5 and 6. Document requests 5 and 6 ask for all correspondence, memoranda, reports, legal opinions, workpapers, and other documents relating to the evaluation of the [redacted] programs for compliance with § 7702 of the Code. [redacted] claims protection of the listed documents under the attorney-client privilege and the work-product doctrine.

[redacted], (b)(7)a

[redacted], (b)(7)a

[redacted], (b)(7)a

[redacted] Federal Rule of Civil Procedure 26(b)(3) states that documents "prepared in anticipation of litigation or for trial" are discoverable only upon a showing of substantial need of the materials and inability, without undue hardship, to

obtain their substantial equivalent elsewhere. Three issues are present: 1) Were these documents prepared "in anticipation of litigation or for trial;" 2) Can the IRS show a substantial need for these documents; and 3) Can the IRS obtain the substantial equivalent of these documents elsewhere.

There are two schools of thought on the issue of whether a document is prepared in anticipation of litigation. The Fifth Circuit allows protection under the work-product doctrine only if the primary motivating purpose behind the creation of the document was to aid in possible future litigation. United States v. Davis, 636 F.2d 1028 (5th Cir), *cert. denied,* 454 U.S. 862, 102 S. Ct. 320, 70 L. Ed. 2d 162 (1981). The Second, Third, Fourth, Seventh, Eighth, and D.C. Circuits have adopted a more expansive definition and protect disclosure of documents if in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation. *See* United States v. Adlman, 134 F.3d 1194 (2d Cir. 1996); In re Grand Jury Proceedings, 604 F.2d 798 (3d Cir. 1979); National Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc., 967 F.2d 980 (4th Cir. 1992); Binks Mfg. Co. v. National Presto Indus., Inc., 709 F.2d 1109 (7th Cir. 1983); Simon v. G.D. Searle & Co., 816 F.2d 397 (8th Cir.), cert. denied, 484 U.S. 917, 108 S. Ct. 268, 98 L. Ed. 2d 225 (1987); Senate of Puerto Rico v. United States Dep't of Justice, 823 F.2d 574 (D.C. Cir. 1987). [redacted]

(b)(7)a

[redacted]

Another way of interpreting the Adlman line of cases is to ask whether the same documents would have been prepared in any event--as part of the ordinary course of business of generating life insurance products--then the court should conclude the documents were not prepared in anticipation of litigation. Adlman, 134 F.3d 1194 (2d Cir. 1996). We bring these cases to your attention, not to opine as to whether the work-product doctrine applies to the present case, but to inform you of the manner in which courts review claims of privilege under the work-product doctrine. Based on the allegations made in [redacted]s privilege log, the documents may or may not be protected under the work-product privilege. Only an enforcement proceeding and an in camera review by a court will determine the application of the privilege.

Can the IRS show a substantial need for these documents? The issue in the present case is not whether [redacted] knew that the COLI products at issue did not meet the requirements of § 7702. The issue is whether the taxpayer engaged in a transaction that had no substance or purpose aside from the taxpayer's desire to obtain the tax benefit of an interest deduction. The economic substance doctrine operates to disallow interest deductions even if the debt incurred as part of the transaction is enforceable under state law and despite the fact that § 163 does not require a profit objective as a prerequisite to the deduction. Knetsch v. United States, 364 U.S. 361 (1960); Peerless Industries v. United States, 37 F.3d 1488 (3d Cir. 1994); United States v. Wexler, 31 F.3d 117 (3d Cir. 1994); Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966). In COLI cases, four factors are of significant importance: 1) funds belonging to an insurance company are "lent" to a customer to pay premiums but the customer is never free to spend the "borrowed" money as he chooses, but rather the funds essentially always remained with the insurer; 2) the customer always paid an interest rate on his debt in excess of the rate at which his investment grew: 3) any value in the annuity obtained by paying premiums was basically eliminated by debt; and 4) the customer would realize only a loss on the transaction unless the deductions were allowed. Emmons v. Commissioner, 31 T.C. 236 (1958). [redacted] The request for the § 7702 line of inquiry came from an attorney in Chief Counsel's F&IP branch. She was informed of [redacted]'s claim of privilege, and her opinion regarding summons enforcement was solicited but not received.

Finally, with respect to the work-product doctrine, Can the IRS obtain the substantial equivalent of these documents elsewhere? The purpose in obtaining these documents is to determine whether the [redacted] policies passed the computations required under § 7702. You have procured expert actuarial assistance to prepare § 7702 computations. It is our conclusion that the expert's computations will be the substantial equivalent of the substance sought in the summonsed documents.

It is our recommendation that enforcement of the [redacted] summons requesting documents not go forward. It does not appear that the hazards associated with the

[redacted], f/k/a [redacted]
Summons Enforcement

attorney-client privilege and the work-product doctrine are outweighed by the need to obtain the information, which can be obtained through the use of your expert.

If you have any questions regarding this memorandum, please contact me at (303) 844-2214 ext. 225.

MARTIN B. KAYE
District Counsel

By: _____
MARK S. HEROUX
Attorney

Enc.: [redacted] Summonses Dated [redacted]
[redacted] Responses (without attached exhibits) dated [redacted], [redacted] and [redacted]

cc: George Imwalle, COLI ISP, Cincinnati
James Hill, COLI ISP Counsel, Cincinnati
John R. Brown, Revenue Agent, Chattanooga